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Fourth report on diplomatic protection

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Addendum

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B. Proposed articles on diplomatic protection of corporations and shareholders (continued)

5. Article 21 (*Lex specialis*)

Article 21
Lex specialis

These articles do not apply where the protection of corporations or shareholders of a corporation, including the settlement of disputes between corporations or shareholders of a corporation and States, is governed by special rules of international law.

106. The fourth report on diplomatic protection draws attention to the fact that today foreign investment is largely regulated and protected by bilateral investment treaties (BITs).[1] The number of BITs has grown considerably in recent years and it is today estimated that there are nearly 2,000 such agreements in existence.[2]

107. BITs provide two routes for the settlement of investment disputes as alternatives to domestic remedies in the host State. First, they may provide for the direct settlement of the investment dispute between the investor and the host State, before either an ad hoc tribunal or a tribunal established by the International Centre for Settlement of Investment Disputes (ICSID) under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.[3] Secondly, they may provide for the settlement of an investment dispute by means of arbitration between the State of nationality of the investor (corporation or individual) and the host State over the interpretation or application of the relevant provision of the BIT. The second procedure is usually available in all cases, with the consequence that it acts as a reinforcement of the investor-State dispute resolution mechanism.

108. Where the dispute resolution procedures provided for in a BIT or ICSID are invoked, customary law rules relating to diplomatic protection are excluded.[4] Both BITs[5] and the ICSID Convention make this clear.[6]

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[1] A/CN.4/530, para. 17.

[2] See Julianne Kokott's interim report on "The Role of Diplomatic Protection in the Field of the Protection of Foreign Investment" to the Committee on Diplomatic Protection of Persons and Property of the International Law Association, in *Report of the Seventieth Conference*, New Delhi (2002), p. 265. See also Kenneth J. Vandevelde, "The Economics of Bilateral Investment Treaties" 4 (2000) 41 *Harvard International Law Journal* 469.

[3] 575 U.N.T.S. 159; (1965) 4 ILM 524.

[4] See Kokott, supra note 2, at p. 268; Paul Peters, "Dispute Settlement Arrangements in Investment Treaties" (1991) 22 *Netherlands Yearbook of International Law* 91.

[5] See the German-Philippine agreement of 18 April 1997, which provides in article 9(3): "Neither Contracting State shall pursue through diplomatic channels any matter referred to arbitration until the proceedings have terminated and a Contracting State has failed to abide by or comply with the award rendered by the International Center for Settlement of Investment Disputes" (cited by Kokott, supra note 2, at footnote 24).

[6] Article 27(1) of the ICSID Convention provides:

> "No contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute."

109. The dispute settlement procedures provided for in BITs and ICSID offer greater advantages to the foreign investor than the customary international law system of diplomatic protection, as they give the investor direct access to international arbitration and they avoid the political uncertainty inherent in the discretionary nature of diplomatic protection.[7]

110. The existence of a special regime of the kind described above was acknowledged by the International Court of Justice in *Barcelona Traction*:

> "Thus, in the present state of the law, the protection of shareholders requires that recourse be had to treaty stipulations or special agreements directly concluded between the private investor and the State in which the investment is placed. States ever more frequently provide for such protection, in both bilateral and multilateral relations, either by means of special instruments or within the framework of wider economic arrangements. Indeed, whether in the form of multilateral or bilateral treaties between States, or in that of agreements between States and companies, there has since the Second World War been considerable development in the protection of foreign investments. The instruments in question contain provisions as to jurisdiction and procedure in case of disputes concerning the treatment of investing companies by the States in which they invest capital. Sometimes companies are themselves vested with a direct right to defend their interests against States through prescribed procedures."[8]

111. The Court preferred to see arrangements of this kind as constituting a *lex specialis* between parties designed to create a special regime of investment protection.[9]

112. Article 21 aims to make it clear that the present draft articles do not apply to the alternative, special regime for the protection of foreign investors provided for in bilateral and multilateral investment treaties. It serves the same function as article 55 of the Commission's Draft Articles on "Responsibility of States for internationally wrongful acts"[10] and reflects the maxim *lex specialis derogat legi generali*. For this principle to apply, "it is not enough that the same subject matter is dealt with by two provisions; there must be some actual inconsistency between them, or else a discernible intention that one provision is to exclude the other".[11] There is a clear inconsistency between the rules of customary international law on the diplomatic protection of corporate investment, which envisage protection only at the discretion of the national State and only, subject to limited exceptions, in respect of the corporation itself, and the special regime for foreign investment established by bilateral and multilateral investment treaties, which confers rights on the foreign investor, either as a corporation or as a shareholder, determinable by an international

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[7] See Kokott, supra note 2 at pp. 276-277, cited in Fourth Report, supra note 1, at pp. 7-8 (para. 17).

[8] 1970 *I.C.J. Reports*, p. 3 at p. 47 (para. 90).

[9] See also ibid., pp. 40-41 (paras. 62-63). Cf. Asoka de Z. Gunawardana, "The Inception and Growth of Bilateral Investment Promotion and Protection Treaties" (1992) 86 *Proceedings of the American Society of International Law* 544, 550.

[10] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 10* and corrigendum (A/56/10 and Corr.1), para. 77, commentary to article 55.

[11] Ibid., para. (4). No attempt is made to discuss the jurisprudence on this subject, as it may be found in the commentary of the Commission to article 55; ibid., para. (5). See also Bruno Simma, "Self-contained Regimes" (1985) 16 *Netherlands Yearbook of International Law* 111.

arbitration tribunal. For this reason a provision along the lines of article 21 is indispensable in the present set of draft articles.

6. Article 22 (Legal persons)

Article 22
Legal persons

The principles contained in articles 17 to 21 in respect of corporations shall be applied mutatis mutandis to other legal persons.

113. The fourth report on diplomatic protection[12] is devoted entirely to a particular species of legal person, the corporation. Article 22 applies the rules expounded in respect of corporations to other legal persons, allowing for the changes that must be made (mutatis mutandis) in the cases of other legal persons depending upon their nature, aims and structure. The comment on this article explains why the focus of attention is, and should be, upon the corporation in the present set of articles and why it is not possible to draft further articles dealing with the diplomatic protection of each kind of legal person.

114. In the ordinary sense of the word, "person" is a human being. In the legal sense, however, a "person" is any being, object, association or institution which the law endows with the capacity of acquiring rights and incurring duties. Legal personality is "not a natural phenomenon but a creature of law".[13] A legal system may confer legal personality on whatever object or association it pleases. There is no consistency or uniformity among legal systems in the conferment of legal personality.

115. In Roman law there were two types of juristic person: the *universitas personarum* and the *universitas rerum*. The former was an association of persons, corresponding more or less to the modern corporation, which included the *fiscus*, municipalities and *collegia fabrorum* (craft guilds). The latter was an aggregate of assets and liabilities which formed a separate legal entity without being connected with any particular person or persons: the *hereditas jacens* (estate without an owner) and *pia causa* (charitable foundation — a complex of assets set aside by a donor or testator for a charitable purpose). In most legal systems based on Roman law, the *universitas personarum* has become the corporation, and the *universitas rerum* has become the foundation (Dutch *stichting*, German *Stiftung*).[14] The *universitas personarum* was, however, restricted mainly to municipalities and guilds throughout the Middle Ages, and it was only in the sixteenth century that the link-up between trading companies and corporate personality came about as a result of the emergence of the joint-stock company.[15]

116. There is jurisprudential debate about the legal nature of juristic personality[16] and, in particular, about the manner in which a legal person comes into being. The

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[12] A/CN.4/530.

[13] J. H. Beale, *Conflict of Laws* (1935), II, para. 120.2.

[14] H. R. Hahlo and Ellison Kahn, *The South African Legal System and its Background* (1968), pp. 104-5.

[15] For example, the Muscovy Company (1555), with a monopoly of trade with Russia, the English East India Company (1600) and the Dutch East India Company (1602).

[16] According to Martin Wolff there are 16 theories on this subject: (1938) 54 *Law Quarterly Review* 496.

fiction theory (associated with von Savigny) maintains that no juristic person can come into being without a formal act of incorporation by the State. This means that a body other than a natural person may obtain the privileges of personality by an act of State, which by a fiction of law equates it to a natural person, subject to such limitations as the law may impose. According to the realist theory, on the other hand (associated with Gierke), corporate existence is a reality and does not depend on State recognition. If an association or body acts in fact as a separate legal entity, it becomes a juristic person, with all its attributes, without requiring grant of legal personality by the State.[17] Whatever the merits of the realist theory, it is clear that, to exist, a legal person must have some recognition by law, that is, by some municipal law system. This has been stressed by both the European Court of Justice and the International Court of Justice. In the *Daily Mail* case on freedom of establishment, the European Court of Justice stated: "It should be borne in mind that, unlike natural persons, companies are creatures of the law ... They exist only by virtue of the varying national legislation which determines their incorporation and functioning."[18] In the *Barcelona Traction* case the International Court declared:

> "In this field international law is called upon to recognize institutions of municipal law that have an important and extensive role in the international field. This does not necessarily imply drawing any analogy between its own institutions and those of municipal law, nor does it amount to making rules of international law dependent upon categories of municipal law. All it means is that international law has had to recognize the corporate entity as an institution created by States in a domain essentially within their domestic jurisdiction. This in turn requires that, whenever legal issues arise concerning the rights of States with regard to the treatment of companies and shareholders, as to which rights international law has not established its own rules, it has to refer to the relevant rules of municipal law. Consequently, in view of the relevance to the present case of the rights of the corporate entity and its shareholders under municipal law, the Court must devote attention to the nature and interrelation of those rights."[19]

117. Given the fact that legal persons are the creatures of municipal law, it follows that there are today a wide range of legal persons with differing characteristics, including corporations, public enterprises, universities, schools, foundations, churches, municipalities, non-profit-making associations, non-governmental organizations and even partnerships (in some countries). The impossibility of finding common, uniform features in all these legal persons provides one explanation for the fact that writers on both public[20] and private[21] international law

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[17] Hahlo and Kahn, supra note 14, at p. 107. See also Note: "What we Talk about when we Talk about Persons: The Language of Legal Fiction" (2001) 114 *Harvard Law Review* 1745.

[18] ECJ, Case 81/87 *The Queen v. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust* [1988] ECR 5483, at para. 19.

[19] 1970 *I.C.J. Reports*, pp. 34-35 (para. 38).

[20] See, for example, I. Brownlie, *Principles of Public International Law*, 5th ed. (1998), pp. 425, 486; P. Daillier and A. Pellet (eds.), *Nguyen Quoc Dinh's Droit International Public*, 6th ed. (1999), p. 492; R. Jennings and A. Watts (eds.), *Oppenheim's International Law*, 9th ed. (1992), vol. 1, pp. 517, 869; D. P. O'Connell, *International Law*, 2nd ed. (1970), pp. 1039ff; A. A. Faturos, "National Legal Persons in International Law" in *Encyclopedia of Public International Law* (ed. R. Bernhardt), vol. 3, p. 495.

[21] See, for example, L. Collins (ed.), *Dicey & Morris on the Conflict of Laws*, 13th ed. (2000), vol. 2, pp. 1101ff; P. North and J. J. Fawcett, *Cheshire & Norths' Private International Law*, 13th ed. (2001), pp. 171ff.

largely confine their consideration of legal persons in the context of international law to the corporation — the commercial, profit-making enterprise whose capital is represented by shares, in respect of which there is a firm distinction between the separate entity of the corporation and the shareholders, with limited liability attaching to the latter.[22] There is, however, a further explanation for this approach on the part of jurists. This is the fact that it is mainly the corporation, unlike the public enterprise, the university, the municipality, the foundation and other such legal persons, that engages in foreign trade and investment and whose activities fuel not only the engines of international economic life but also the machinery of international dispute settlement. Diplomatic protection in respect of legal persons is mainly about the protection of foreign investment. This is why the corporation is the legal person that occupies centre stage in the field of diplomatic protection[23] and why the present set of draft articles do — and should — concern themselves largely with this entity.

118. While the corporation is the principal legal person for the purposes of diplomatic protection, it is not the only legal person that may require such protection.

119. The case law of the Permanent Court of International Justice shows that a commune[24] (municipality) or university[25] may in certain circumstances qualify nationals of a State as legal persons. There is no reason why such legal persons should not qualify for diplomatic protection if injured abroad, provided that they are autonomous entities not forming part of the apparatus of the protecting State. As diplomatic protection is a process reserved for the protection of natural or legal persons not forming part of the State, it follows that in most instances the municipality, as a local branch of government, and the university, funded and, in the final resort, controlled by the State,[26] will not qualify for diplomatic protection.

120. Non-profit-making foundations, comprising assets set aside by a donor or testator for a charitable purpose, constitute legal persons without members. Today many foundations fund projects abroad to promote health, welfare, women's rights, human rights and the environment in developing countries. Should such a legal person be subjected to an internationally wrongful act by the host State, it is probable that it would be granted diplomatic protection by the State under whose laws it has been created. Non-governmental organizations engaged in worthy causes

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[22] For a description of these common features of a corporation, see *Barcelona Traction*, 1970 *I.C.J. Reports*, p. 34, paras. 40-41.

[23] According to Brownlie, supra note 20, "a major issue concerning corporations is the right to exercise diplomatic protection in respect of the corporation and its shareholders" (p. 426).

[24] In *Certain German Interests in Polish Upper Silesia* the Permanent Court held that the commune of Ratibor fell within the category of "German national" within the meaning of the German-Polish Convention concerning Upper Silesia of 1922. *P.C.I.J. Reports*, Series A, No. 7, pp. 73-75.

[25] In *Appeal from a Judgment of the Czechoslovak-Hungarian Mixed Arbitral Tribunal (Peter Pázmány University v. Czechoslovakia)* the Permanent Court held that the Peter Pázmány University was a Hungarian national in terms of article 250 of the Treaty of Trianon and therefore entitled to the restitution of property belonging to it. *P.C.I.J. Reports*, Series A/B, No. 61, pp. 208, 227-232.

[26] Private universities such as those found in the United States of America would qualify for diplomatic protection; as would private schools, if they enjoyed legal personality under municipal law.

abroad would appear to fall into the same category as foundations. Karl Doehring, however, has argued otherwise.[27] He notes that:

> "the non-governmental organization is a legal subject, a juristic person, which obtained its personality from a national legal order. The members of the non-governmental organization are not the States or their Governments but private persons having the nationality of a foreign State, or national associations registered in a foreign State, or enterprises registered in foreign States. The non-governmental organization itself is normally registered in the State in which its administration or headquarters exercises its functions so that it possesses the nationality of this State. This incorporation of the non-governmental organization into a national legal order is an unavoidable prerequisite of its capacity to act as a legal person when administering its own affairs, e.g. when buying materials or renting a residence. This way the non-governmental organization possesses a nationality in spite of the fact that its tasks are of international concern. But, since the organization is not a subject of international law we are forced to go back to its national status when its legal relations are at stake."[28]

However, he then argues that such an NGO has insufficient connection with its State of registration to qualify for diplomatic protection. Its worldwide membership and activities, he claims, results in a situation in which an injury to an NGO cannot, in terms of the *Mavrommatis* rule, be seen as an injury to the State of registration.[29] This is a controversial line of reasoning which pays too much attention to *Nottebohm*[30] and too little attention to *Barcelona Traction*. Nevertheless it highlights the fact that different legal persons present different issues and perspectives which cannot be codified in a single provision.

121. The infinite variety of forms that legal persons may take is probably best represented by the partnership. In most legal systems partnerships are not legal persons and "it is the interests of the individual partners which are protected by international law".[31] In some legal systems, however, the partnership enjoys legal personality,[32] in which case it might be suggested that the individual partners should be treated in much the same manner as shareholders. The problem is illustrated by the European Economic Interest Grouping (EEIG), created by European Community law.[33] According to article 1 (2) of the regulations creating that entity, "A grouping so formed shall, from the date of its registration as provided for in article 6, have the capacity, in its own name, to have rights and obligations of all kinds, to make contracts or accomplish other legal acts, and to sue and be sued." Article 1 (3) then stipulates: "The member States shall determine whether or not groupings registered

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[27] "Diplomatic Protection of Non-Governmental Organizations", in *El derecho internacional en un mundo en transformación: liber amicorum en homenaje al professor Eduardo Jiménez de Aréchaga* (1994), pp. 571-580.

[28] Ibid., p. 572.

[29] Ibid., p. 573.

[30] 1955 *I.C.J. Reports* 4.

[31] O'Connell, supra note 20, p. 1049.

[32] A. Dorresteijn, I. Kuiper and G. Morse, *European Corporate Law* (1994), p. 13. Some European countries recognize a form of "modified legal personality" in which partners do not enjoy limited liability: ibid.

[33] Council Regulation (EEC) No. 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG); OJ No. L 199, 31/07/1985, p. 1.

at their registries, pursuant to article 6, have legal personality." The *same* types of entities, endowed with *equal* legal capacities by a *uniform* statute, may therefore be granted legal personality in one European Union member State and left without it in another.

Although the common law treats companies and partnerships as entirely separate creatures, some legal systems recognize hybrid forms. Germany, for instance, knows the *Kommanditgesellschaft auf Aktien* (KGaA) which has shareholders, as in the case of a public company (*Aktiengesellschaft* (AG)), but one or more of them have unlimited liability and are usually the directors or managers. The KGaA has legal personality and must have at least one general partner; while the shareholders as between themselves are governed by the rules relating to the AG.[34]

122. This brief survey of some of the species of legal person is designed to show the impossibility of drafting separate and distinct provisions to cover the diplomatic protection of different kinds of legal persons. The wisest, and only realistic, course is to draft a provision that extends the principles of diplomatic protection adopted for corporations to other legal persons — subject to the changes necessary to take account of the different features of each legal person. The proposed provision seeks to achieve this. Most cases involving the diplomatic protection of legal persons other than corporations will be covered by draft article 17, which is currently before the Drafting Committee in the following revised form:

> "For the purposes of diplomatic protection of corporations, a State of nationality means a State under whose law the corporation was formed and in whose territory it has its registered office or the seat of its management or some similar connection."[35]

In terms of article 22, a State will have to prove some connection of the kind described in article 17 between itself and the injured legal person as a precondition for the exercise of diplomatic protection. The language of article 17 is, it is believed, wide enough to cover all cases of legal persons, however different they may be in structure or purpose. Articles 18 and 19 will not apply to legal persons without shareholders, while article 20, dealing with the principle of continuous nationality, will apply.

123. Latin maxims have largely fallen into disfavour. The maxim "mutatis mutandis" is, however, a useful drafting device.[36] Of course it would be possible to say: "The principles contained in articles 17 to 21 in respect of corporations shall be applied to other legal persons, allowing for the adjustments that must be made to cover the different characteristics of each such legal person." The use of the maxim "mutatis mutandis" does, however, convey the same meaning in a more economical and elegant manner.

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[34] Supra note 32, pp. 25-26.

[35] ILC(LV)/DC/DP/WP.1.

[36] Bryan A. Garner, in *A Dictionary of Modern Legal Usage*, 2nd ed. (1995), states that "Mutatis mutandis is a useful Latinism in learned writing, for the only equivalents are far wordier."